

Internal Revenue Service

Number: **201433005**

Release Date: 8/15/2014

Index Number: 856.01-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:FIP:B03

PLR-112762-14

Date: May 5, 2014

Legend

Taxpayer =

Bank A =

Bank B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

a =

b =

c =

d =

State =

Partnership =

LLC 1 =

LLC 2 =

LLC 3 =

Dear :

This responds to a letter dated March 21, 2014, submitted on behalf of Taxpayer. Taxpayer requests a ruling under § 856(c)(5)(J)(i) of the Internal Revenue Code ("Code") that patronage dividends included in its gross income under § 1385 are excluded from its gross income for purposes of §§ 856(c)(2) and (c)(3).

FACTS

Taxpayer elected to be treated as a real estate investment trust ("REIT") for federal income tax purposes beginning with its taxable year ended Date 1. Taxpayer is a calendar year taxpayer that uses an overall accrual method of accounting.

Taxpayer is a publicly traded REIT whose primary business is to own, manage, acquire, and dispose of timberland properties. Taxpayer conducts substantially all of its business through Partnership, a State limited partnership, which is currently disregarded for federal income purposes. Additionally, Partnership conducts significant activity through LLC 1, a State limited liability company, which is also disregarded for federal income tax purposes.

Almost entirely in connection with the acquisition of certain timberland, LLC 1 and LLC 2 entered into a debt financing arrangement with Bank A, Bank B, and various other lenders on Date 2, which included a first mortgage loan and a second mortgage loan. Bank A was the administrative agent and collateral agent for the first mortgage loan, and Bank B was the administrative agent and collateral agent for the second mortgage loan. On Date 3, Partnership and LLC 1 entered into an Amended and Restated Credit Agreement with Bank A, LLC 3, and other lenders. Bank A and LLC 3 served as co-lead lenders and Bank A served as administrative agent. The proceeds were used to pay off the amounts under the then existing first mortgage loan and second mortgage loan.

On Date 4, Partnership and LLC 1 entered into a Second Amended and Restated Credit Agreement with Bank A and other lenders, with Bank A as the administrative agent. The proceeds of which were used to pay off the outstanding balance of the

Amended and Restated Credit Agreement and to partially fund the acquisition of additional timberland.

On Date 5, Partnership and LLC 1 entered into the Third Amended and Restated Credit Agreement for approximately \$a with Bank A, as the administrative agent, and certain other lenders. This agreement provides for borrowing consisting of a) a \$b revolving credit facility, b) a \$c multi-draw term credit facility, and c) the remaining amount outstanding under the Second Amended and Restated Credit Agreement of approximately \$d.

Bank A is a cooperative subject to taxation under §§ 1381-1388 and is subject to regulation by the Farm Credit Administration. Taxpayer represents that it does not receive "patronage dividends" under the Third Amended and Restated Credit Agreement. Taxpayer intends to amend the Third Amended and Restated Credit Agreement so that it may receive patronage dividends from Bank A.

Patronage dividends are generally paid either in cash or in both cash and equity. Taxpayer represents that with respect to the patronage dividends it expects to receive, each will be a "patronage dividend" within the meaning of the term provided in § 1388(a). Taxpayer is required for federal income tax purposes, under § 1385, to include in gross income all patronage dividends it receives. However, for financial reporting purposes, Taxpayer represents that it will reduce its interest expense by the amount of patronage dividends received.

LAW & ANALYSIS

Section 856(c)(2) provides that in order for a corporation to qualify as a REIT, at least 95 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from sources that include dividends, interest, rents from real property, and gain from the sale or other disposition of stock, securities, and real property (other than property in which the corporation is a dealer).

Section 856(c)(3) provides that in order for a corporation to qualify as a REIT, at least 75 percent of the corporation's gross income (excluding gross income from prohibited transactions) must be derived from rents from real property, interest on obligations secured by real property, gain from the sale or other disposition of real property (other than property in which the corporation is a dealer), dividends from REIT stock and gain from the sale of REIT stock, abatements and refunds of taxes on real property, income and gain derived from foreclosure property, commitment fees to make loans secured by mortgages on real property or to purchase or lease real property, gain from certain sales or other dispositions of real estate assets, and qualified temporary investment income.

Section 856(c)(5)(J) provides that to the extent necessary to carry out the purposes of Part II of subchapter M of the Code, the Secretary is authorized to determine, solely for purposes of such part, whether any item of income or gain which – (i) does not otherwise qualify under §§ 856(c)(2) or (c)(3) may be considered as not constituting gross income for purposes of §§ 856(c)(2) or (c)(3), or (ii) otherwise constitutes gross income not qualifying under §§ 856(c)(2) or (c)(3) may be considered as gross income which qualifies under §§ 856(c)(2) or (c)(3).

Section 301(a) provides that in general, except as otherwise provided in this chapter (chapter 1 of subtitle A of the Code, which chapter and subtitle include, among other sections, §§ 301, 316, 317, 856, and § 1388), a distribution of property (as defined in § 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in § 301(c).

Section 301(c) provides, in part, that in the case of a distribution to which § 301(a) applies, that portion of the distribution which is a dividend (as defined in § 316) shall be included in gross income.

Section 316(a) provides that for purposes of this subtitle (subtitle A, which subtitle, as noted, includes, among other sections, both § 856 and § 1388), the term “dividend” means any distribution of property made by a corporation to its shareholders-- (1) out of its earnings and profits accumulated after February 28, 1913, or (2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Section 316(a) provides in the flush language that, except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. The flush language provides further that to the extent that any distribution is, under any provision of this subchapter (subchapter C of chapter 1 of subtitle A of the Code), treated as a distribution of property to which § 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

Section 1388(a) provides that, for purposes of subchapter T, the term "patronage dividend" means an amount paid to a patron by an organization to which part I of subchapter T applies--

(1) on the basis of quantity or value of business done with or for such patron,

(2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and

(3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

The flush language of § 1388(a) provides that such term does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions. The flush language provides further that, for purposes of paragraph (3), net earnings shall not be reduced by amounts paid during the year as dividends on capital stock or other proprietary capital interests of the organization to the extent that the articles of incorporation or bylaws of such organization or other contract with patrons provide that such dividends are in addition to amounts otherwise payable to patrons which are derived from business done with or for patrons during the taxable year.

Section 1385(a)(1) provides, in part, that, except as otherwise provided, each person shall include in gross income the amount of any patronage dividend which is paid in money, a qualified written notice of allocation, or other property (except a nonqualified written notice of allocation), and which is received by him during the taxable year from an organization described in § 1381(a).

The legislative history underlying the tax treatment of REITs indicates that a central concern behind the gross income restrictions is that a REIT's gross income should largely be composed of passive income. For example, H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, at 822-23 states, "[o]ne of the principal purposes of your committee in imposing restrictions on types of income of a qualifying real estate investment trust is to be sure the bulk of its income is from passive income sources and not from the active conduct of a trade or business."

Patronage dividends paid by a subchapter T cooperative are a return of earnings to its cooperative patrons based on the amount of business that the patron transacts with the cooperative. The patronage dividends paid by a subchapter T financing cooperative effectively reduce the costs that its patrons incur to borrow funds from the cooperative. The amounts paid by Banks A represent earnings that the cooperative is able to refund to Taxpayer based on the average amounts that Taxpayer borrowed from the banks during the prior year. Thus, while Taxpayer must include patronage dividend income in its gross income under § 1385(a)(1), the patronage dividends Taxpayer receives effectively reduce Taxpayer's interest expense paid during the prior year. Under the facts of the instant case, exclusion of these patronage dividends from gross

income for purposes of §§ 856(c)(2) and (c)(3) does not interfere with Congressional policy objectives in enacting the income tests under those provisions.

CONCLUSION

Accordingly, pursuant to § 856(c)(5)(J)(i), we conclude that the patronage dividends included in Taxpayer's gross income under § 1385 are excluded from its gross income for purposes of §§ 856(c)(2) and (c)(3).

This ruling's application is limited to the facts, representations and Code sections cited herein. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed with regard to whether Taxpayer otherwise qualifies as a REIT under subchapter M of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Julanne Allen
Assistant to the Branch Chief, Branch 3
Associate Chief Counsel
(Financial Institutions & Products)